

## An Examination of Life Lease Housing Issues

### INTRODUCTION

Freehold ownership, rental, condominium and co-operative housing have been the most popular types of tenure in Canada for many years. In response to emerging consumer needs and preferences and new economic and government policy trends, Canada's housing industry has taken new approaches to housing tenure in the last decade. As a result, new types of tenure are being made available to Canadians, notably, leaseholds, shared equity ownership and life leases. A life lease is a legal agreement that permits purchasers to occupy a home for life (or until they are no longer capable of living there) in exchange for an initial lump sum payment and subsequent monthly payments to cover the ongoing project management fees and maintenance and operating expenses (and in some cases rent, depending on the size of the initial payment).

Currently all life lease housing projects are located west of the Ontario-Quebec border. With the rapid aging of the Canadian population, it is possible that the popularity of life leases will continue to grow into the future and expand into other parts of Canada. The exact number of life lease projects in Canada is unknown; in 2003, the number was estimated at more than 200 (Lumina Services Inc. 2003). The total number of life lease developments can currently be estimated very conservatively at 287. These numbers are estimates since there is no requirement for life lease developments to be registered. This indicates an increase of at least 40 per cent in three years.

Manitoba is the only province to have enacted legislation specific to life lease housing:<sup>1</sup> the *Life Leases Act*, December 1999, amended June 2005, although other provinces are studying the possibility of introducing similar legislation. Some regulatory mechanisms apply in provinces (other than Manitoba) within existing legislation not specifically developed for life lease housing.

As the number of life lease projects increases, there are questions about the attributes and the long-term performance of the life lease concept. One is that the life lease concept may not be well understood by all stakeholders, including consumers, sponsors, lenders, mortgage underwriters and policy makers. Another is the absence of legislation (except in Manitoba) specific to life leases which would protect and clarify both consumer and sponsor rights.

Life lease projects raise a variety of consumer protection issues as well as issues faced by sponsors of life lease developments and lenders and other advisors. These include, but are not limited to: legislation, financing, management, sustainability of operations and security of tenure. Clearly, these issues have the potential to cause major problems for seniors, sponsors and lenders if something goes wrong in a project.

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<sup>1</sup> B.C. has several pieces of real estate legislation that apply to life lease developments as well as other forms of real estate

## OBJECTIVES

The objective of the study was to produce a comprehensive, well-written and useful research report to provide target audiences with the information they need to better understand and respond to a number of issues related to life lease housing. The target audience includes prospective residents, sponsors, life lease development consultants, lenders, researchers and provincial, territorial and municipal governments. It is expected that the information in this report will be useful to these primary audiences and assist them in dealing with issues related to life lease housing.

## FORMS OF LIFE LEASE HOUSING

Significant variation exists between and within provinces in how individual life lease projects are developed and managed. There are five basic forms of model:

- **Zero-balance** — The resident pays an amount up front designed to prepay rent for his/her expected remaining life. No residual value is repaid to the occupant or their estate at the time of departure or death. Consequently, the purchase price for an interest in this type of life lease is least expensive relative to other forms.
- **Declining Balance** — The resident pays an amount up front based on life expectancy. The estate is paid a residual value which declines each year to zero at the end of specific period of time. This type of life lease is slightly more expensive than the zero-balance form.
- **No Gain** — The amount redeemed at the time of sale remains the same as that paid at the time of initial occupancy in nominal terms, though declining in real terms, as there is no provision for annual inflationary increases to be taken into account. This is in essence a zero-interest loan to the sponsor for the time of occupancy of the unit.
- **Price Index** — Redemption value increases based on annual price index factor being applied to the purchase price, for instance, the Consumer Price Index (CPI). This has certain risks for the sponsor if real estate values are increasing more slowly than general inflation.
- **Market Value** — The life lease interest is redeemed at whatever price the market will bear at the time of sale. Purchasers pay an amount similar to that for a comparable condominium unit.

## METHODOLOGY

Several perceived issues related to life lease housing were identified in the terms of reference for the study and through a literature review. Information was gathered through three mechanisms:

- Case studies of 15 life lease developments from B.C. to Ontario were conducted. This involved an in-depth interview with the project manager, a site visit and a review of materials gathered during the visit. While this number of case studies does not allow us to fully comment about life lease projects in general, the in-depth knowledge generated through this method was very useful. Many common themes emerged from the case studies, as well as individual concerns/features identified at each of the sites. The case studies were spread out as follows: Ontario (five), Manitoba (three), Saskatchewan (two), Alberta (two) and B.C. (three). In Ontario two case studies were completed in the greater Toronto area (GTA) and three outside Toronto in southern Ontario.
- Focus groups were set up in each of the 15 case study settings, with the co-operation of the sponsor. To encourage attendance, participants were offered the chance to win a cash prize at the end of the session by randomly drawing the name of one participant (in one case this money was donated to the resident's fund at the request of the residents). There were two components to the data gathering from focus group participants. The focus group interview guideline was used to generate a guided but open-ended discussion about issues affecting residents and their decision to live in life lease housing. There were six major topics covered (decision to purchase, financing, costs [initial and monthly fees], resident involvement in management, security of tenure and of invested capital, and overall satisfaction with life lease). The second component of data collection in the focus group sessions was completion of a brief questionnaire filled out by each focus group participant after the discussion. A total of 272 residents participated in focus group sessions and 238 usable questionnaires were received.

- Interviews were conducted with key informants knowledgeable about various aspects of life lease development, financing and management. A carefully constructed list of key informants was assembled. The names were obtained through a literature review, a thorough examination of contributors to recent reports and articles related to life lease housing, suggestions from the provincial representatives and an examination of life lease sites on the Internet. This list was supplemented through referrals from other key informants as the interviews progressed. People on this list were interviewed (in person or by telephone) to get feedback on issues not covered in the case studies and focus groups. In total, over 50 key informants were contacted. Interview guidelines were developed for discussion with key informants, for interviews with project sponsors and for the focus group sessions with residents.

## FINDINGS AND CONCLUSIONS

There are several issues related to life lease stemming from the fact that there is no legislation covering most of the developments in Canada. Except in Manitoba, the tenure status of residents is a grey area, particularly for market value life leases. The sponsor holds title to the building and is responsible for ensuring it is well-maintained and holds its value. Life lease holders have the right to occupy their unit. However, the life lease holder is also greatly concerned with ensuring the building is well-managed, that there is continuing demand and a waiting list for units and that, ideally, the market value of the life lease interest increases over time (or at least does not diminish). In most complexes, however, the sponsor is the only entity that has any real control over how the building is managed. In most case studies, residents are informed about operating budgets and management decisions but have no input into how these are determined.

The life lease concept and operation is not clearly understood by some professional advisors, lenders and some occupants. There is a need for education about the pros and cons of owning a life lease interest relative to other forms of tenure. There is also a need for disclosure requirements before seniors purchase their interest to ensure they are aware of the potential risks they face in their particular development. Life lease purchasers need to understand their limited control over decisions about management of the building, compared to that

of a condo owner for example, before they make their purchase. They also need to understand the risk they face that they may not receive their capital back in a timely manner (or at all if the sponsor becomes insolvent) if the real estate market is poor (market value model) or the sponsor has insufficient reserves/prospective new purchasers to pay all claimants (in a model where return of a specific amount of capital is guaranteed when the resident vacates). The risks relative to value of the asset at sale faced by those buying under the life lease model are greater than those of investing in a condominium due to lack of legislative protection and the added risk of being able to sell only to seniors.

Non-profit sponsors, for whom this may be their first real estate development, also need assistance with this process to avoid financial and reputation problems. Life lease agreements varied considerably across the country. In some cases this left residents unprotected in certain areas but in other situations, sponsors were vulnerable.

## RECOMMENDATIONS

### Legislation

- Consideration should be given in each province (except Manitoba where legislation has already been adopted) to creating life lease legislation in the way that condominium legislation was identified as a need when this form of tenure became popular. All five provinces have condo or strata title legislation; life lease housing needs similar attention. A single life lease act has the advantage that sponsors, residents and their advisors can find appropriate information in one place. Alternatively it is possible that the identified potential consumer protection gaps can be addressed through tweaking existing legislation; for example, B.C. has the *Real Estate Development Marketing Act* which identifies disclosure requirements for marketing all residential real estate including life lease units. There is a need for consumer protection legislation of some form to address the concerns cited above.
- Any legislation developed should be flexible within each province to recognize existing variations in life lease form and continue to allow creativity in developing new forms of life lease housing.

#### ■ Legislation should include:

- rescission period (seven days as for condominium purchases)
- how life lease interest can be registered
- tenant representation on Board
- clarification of whether provincial rent control legislation affects increases in monthly occupancy fees
- under what conditions deposits may be used by developer to fund construction (or for other purposes)
- reserve fund requirements (analogous to condo legislation)
- disclosure prior to marketing of: who the owner/operator of the housing will be (often this is a separate foundation rather than the parent non-profit company), term of the lease, investment requirement, method of sale of interest and/or other options for termination of the lease by either side, risks associated with obtaining refund of entrance fee/leasehold cost, who is responsible for paying occupancy charges and property taxes, common areas and facilities to be included in the development, estimated date of construction start and completion, construction warranties, planning approval/building permit obtained, how development will be financed, (see *Manitoba Life Lease Act* and B.C. *Real Estate Development Marketing Act*).

#### Resident Involvement in Management

- Sponsors should be required by legislation to create a minimum number of spaces on the board for residents; this is likely to increase resident satisfaction and consequently, resale demand and value; these positions could be non-voting or could have voting rights.

#### Documentation

- There is a role for a base, life lease document that new sponsors could adapt for their project, to ensure they cover all clauses that should be included to protect their residents and the sponsor themselves. It may be that there are several versions—one for the “pure” market value model, one for the guaranteed buyback model, etc. These may not be province specific but rather life lease model specific.

#### Financing

##### Construction financing

- Criteria that must be met to get advances under this financing (number of units sold, time limits on these sales, etc.) need to be made clear to the sponsor up front. This is likely done by most lenders but recognition of the lack of real estate experience among sponsors may mean this information needs extra emphasis or frequent repeating. This becomes more important when purchaser's deposits are not protected against unlimited use in the construction process as they are in Manitoba.
- A development advisor and/or an experienced construction project manager are needed to ensure the construction costs are monitored and the marketing plan ensures units are sold on schedule.

##### Long-term mortgage financing for sponsors

- If the sponsors need long-term financing to cover some development costs, they will not want resident interests registered on title unless they are subordinate to the lender's debt. However, this puts the life tenant at risk as the mortgage may take priority over the life lease holder's interest and their capital investment could be lost.
- The priority of the loan relative to residents' deposits/investments needs to be clear in the legislation. Will lenders have access to deposits if the loan is in default? Whichever way this is decided it has implications for the residents or the lender.

##### Long-term mortgage financing for residents would be easier to obtain if:

- Units were covered under provincial warranty programs
- A resident's interest in the life lease was somehow recorded on the title. This conflicts with the interests of the lender if the sponsor wants a long-term mortgage on the property. However, this puts the life tenant at risk as the mortgage may take priority over the life lease holder's interest and their capital investment could be lost. It may be that the resident will not be allowed to finance his interest if the sponsor has a permanent mortgage loan, or that the resident will have to have a subordinated loan.

### Professional Advice

- Seniors should be strongly encouraged to seek professional advice before purchasing a life lease interest. The Manitoba legislation requires this advice be given in writing during the marketing phase. This recommendation is based on the complexity of this type of investment and the evidence from the focus group session that not all residents understood the nature of what they had purchased. It is critical however, that advisors be well versed in life lease issues, through the education process suggested below.

### Education

- Most seniors are not familiar with the life lease concept. Similarly, there is a lack of understanding among lenders, accountants, lawyers and others about what life lease is and the benefits and risks of investing in a life lease unit. Many seniors in the focus groups indicated they were advised by lawyers or accountants not to purchase their unit but did so anyway because they liked the design and location of the complex and trusted the sponsor. Some of this reluctance by advisors was based on lack of understanding and some on legitimate concerns. A website and other sources of life lease information, operated by an independent body, would greatly assist in this education process.

### New Sponsors

It is important for sponsors to carefully consider the intricacies of providing this form of housing. In particular, they need to:

- Carefully choose a location that will appeal to prospective residents and is accessible to services required by this age group. In some cases, sponsors acquired land on the outskirts of a community, where it was plentiful and cheaper than land closer to the core. While this led to beautiful “nature” settings, which residents liked, it also meant that a car was required to get to services. Sponsors need to consider the implications of this as their population ages.
- Carefully consider what services to offer in the new building. The costs of these need to be borne by the residents (unless the sponsor consciously chooses to subsidize them). If they are too expensive, or too difficult to estimate costs for, residents may balk at paying for them; if they have to be discontinued, some residents who bought because these services were offered will be dissatisfied.
- Carefully choose the design for the building and units, in conjunction with someone familiar with senior’s issues and needs and preferably with a focus group of potential purchasers. While most buildings were designed to be accessible, with wider hallways and lever door handles etc., residents had complaints about other features in some units. For example, one building had high bathtubs and residents would have preferred walk-in showers and/or tubs with low sides and grab bars.
- Inform themselves fully (and very early in the planning process) about the intricacies of obtaining financing for the construction of a life-lease project.

## Research Highlight

### An Examination of Life Lease Housing Issues

**CMHC Project Manager:** Luis Rodriguez, Policy and Research Division.

**Research Report:** *An Examination of Life Lease Housing Issues*

**Principal Investigators:** GGA Management Consultants

#### Housing Research at CMHC

Under Part IX of the *National Housing Act*, the Government of Canada provides funds to CMHC to conduct research into the social, economic and technical aspects of housing and related fields, and to undertake the publishing and distribution of the results of this research.

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